08.05.2009

**OVERVIEW OF JSC PAREX BANKA TAKEOVER**

On 8 November 2008, the Cabinet of Ministers decided on the take-over of JSC *Parex banka* by the Latvian State through the state-owned JSC *Latvijas Hipotēku un zemes banka (Mortgage and Land Bank of Latvia)*. It was an unprecedented event in the Latvian financial sector therefore raising numerous questions and yet more manifold opinions. Variety of interpretations was also boosted by initially limited information as a number of documents were classified as secret or restricted use information in accordance with the Law on the State Secret and Information Disclosure Law for the purposes to protect legal rights and justified interests of the recipient of financial services (incl. depositors), state and business participants.

The objective of this overview is to inform the public about the reasons and necessity for the takeover of JSC *Parex banka*, its course of developments and results.

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| *Abbreviations used:* |
| EC – European Commission |
| EBRD – European Bank for Reconstruction and Development |
| FCMC – Financial and Capital Market Commission |
| MoF – Ministry of Finance of the Republic of Latvia |
| BoL – Bank of Latvia |
| Mortgage Bank – state-owned *Latvijas Hipotēku un zemes banka* (Mortgage and Land Bank of Latvia) |
| Cabinet – Cabinet of Ministers of the Republic of Latvia |
| PA – state JSC Privatisation Agency |
| *Parex* – JSC *Parex banka* |

## 1. REASONS AND PREHISTORY OF TAKEOVER

### 1.1. Changes in the global financial system

Changes in the global financial system occurred firstly in the high-risk mortgage lending market of the United States already in 2007 and then spreading across also other global financial markets. The instability of the global financial system had an impact on the European Union (EU) member states as well. In early 2008, Britain's *Northern Rock* was nationalized by the state to bail the bank out. In the second half of 2008, several large and highly approved banks and financial institutions went bankruptcy, for instance, *Lehman Brothers* in the United States and *Carnegie* in Sweden.

These developments of international scale raised anxiety about the overall stability of banking and financial systems. Financial institutions were attempting to attract additional capital considering extraordinary options, including mergers and asking for the Government bailout, as well as increasing liquid asset volumes (improving liquidity). As Latvia is part of integrated global financial system, recent developments, insolvency and financial problems of leading banks made more cautious also the Latvian public and responsible authorities.

### 1.2. FCMC inspections

In view of instability of banking system in other EU member states, FCMC, the responsible supervisory authority for the Latvian financial and capital markets, has been carrying out increased oversight of bank sector already since the summer 2008 in order to monitor daily liquidity positions and the risks of banks in Latvia, including *Parex*.

The financial situation became yet more unpredictable under the impact of global recession therefore negative changes could occur in a comparatively short period of time. Supervision conducted by FCMC allowed to identify and react to the actual situation in *Parex*; however, practical and urgent financial assistance was needed for improving the situation, which could be offered only by the Cabinet.

Following supervision measures regarding *Parex* have been taken by FCMC since the summer 2008, illustrating fast developments:

| *Date* | *Measure taken* |
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| 30.07.2008-15.08.2008 | FCMC invited representatives of *Parex* to the meeting of the Board of FCMC to discuss the results of bank exposure assessment pursuant to inspection findings. And consider lending policy (supervision and assessment of loans issued by the Bank and loan portfolio concentrations), investment policy (compliance with financial instruments concentration and limits), monitoring of the Bank's client and customer service. |
| 18.08.2008 – 03.10.2008 | FCMC conducted inspection in *Parex* with purpose to review and assess the Bank's lending process. Material shortcomings were identified in the lending procedure during the inspection. In the situation of changing economic situation in Latvia and in the world and because of worsening of borrowers creditworthiness, the Bank had not made provisions appropriate to the quality of loan portfolio (deficiency in provisions totalling 40 million lats), as well as drawbacks in credit risk management. |
| 14.10.2008 | FCMC permitted *Parex* to include audited profit for the first-half of 2008 in the amount of 10 438 000 lats in Tier 1 capital and the audited profit for first-half of 2008 in the amount of 11 608 000 lats in Tier 1 of *Parex* consolidated group. This decision attested to the relatively stable standing of *Parex* still in mid-October 2008. |
| 20.10.2008 | As a result of inspection (18.08.2008 - 03.10.2008) more exact information was obtained about the actual financial standing of *Parex* at that moment. FCMC notified *Parex* of the deficiencies identified in the inspection and invited representatives of *Parex* to discuss possibilities to remedy the situation. After initial refusal, a meeting between the FCMC and *Parex* representatives took place only in a week. |
| 22.10.2008 | A meeting between representatives of MoF, FCMC, State Treasury and *Parex* was held where possibilities that *Parex* could receive the Government bailout were discussed. Over the period of preceding days liquidity ratio had already dramatically decreased in *Parex* and assistance was needed to maintain the Bank's solvency.<br>*Parex* in its letter to MoF requested to place 300 000 000 euro from the State Treasury in *Parex* as a deposit for one year, however, the MoF pointed out that the State Treasury had not such amount in its possession for blocking in deposits. |
| 27.10.2008 | FCMC requested *Parex* to submit the capital restoration plan.<br>Increasing deposit withdrawal from *Parex* was observed on this date totalling about 29 million lats. |

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| 28.10.2008 | FCMC informed BoL governor and minister of finance in writing about the problems with capital adequacy and liquidity in *Parex*. The Bank's liquidity indicator was 7,89%, falling below the regulatory minimum (8%). |
| 29.10.2008 | FCMC held a meeting with *Parex* representatives to discuss *Parex* loan assessment and provisioning policies.<br>Outflows of deposits from *Parex* still continued: about 14 million lats were withdrawn over the day. |
| 29.10.2008-<br>07.11.2008 | FCMC conducted an inspection in *Parex* aimed at assessing the Bank's financial instruments portfolio on 31.10.2008. During the inspection it was ascertained that the Bank had to revaluate financial instruments portfolio, and as a result the portfolio shrank by 28 million lats (revaluation and provisions). |
| 31.10.2008-<br>21.11.2008 | FCMC performed an inspection in *Parex* with a purpose to carry out assessment of loans granted after 20.06.2008, as well as evaluation of the *Parex* daughter companies' bills in the Bank's balance. As a result of the inspection, insufficient amount of provisions in the Bank was identified in the amount of 5 million lats. |
| 31.10.2008 | *Parex* regulatory minimum indicators (capital adequacy ratio, liquidity ratio) rapidly deteriorated, as well as deposit outflow continued. On 29.10.2008, liquidity ratio was 33.41% (minimum regulatory requirement in accordance with the FCMC Regulations on the Compliance with Liquidity Requirements: 30%), had contracted by more than 11 percent points since 31.08.2008. In the period from 31.08.2008 to 31.10.2008, withdrawal of deposits amounted over 191 million lats. Capital adequacy fluctuated around the critical margin of 8%. Consequently, the Board of FCMC passed a decision to impose increased control over activities of *Parex*, forbidding *Parex* to issue new loans and acquire new financial instruments. Moreover, *Parex* was requested to immediately take steps to increase the Bank's equity capital. *Parex* shareholders invested 3 million lats in *Parex* subordinated capital. |

At the very beginning of November 2008 it was evident that *Parex* faced rather serious problems and involvement of the Cabinet was required for their tackling. Takeover of *Parex* was considered as one of the most efficient scenarios for ensuring stabilization of the Latvian financial system. It was ascertained that *Parex* had sufficient amount of assets and financial instruments to stabilize activities of *Parex*, by taking full control over the Bank by the State and applying the necessary support to it.

### 1.3. Reasons behind problems occurring particularly with *Parex*

Key reasons for *Parex* crisis:

- global financial market turmoil;
- increased deposit withdrawal from *Parex* as a result of rumours and deficiency in *Parex* client financial resources, in particular regarding Latvian neighbouring countries' residents;
- *Parex* had entered into two agreements with syndicated lenders, – a 500 million euro loan on 29 June 2007 2 and a 275 million euro loan on 21 February 2008. Repayment of loans was scheduled in early 2009, however, *Parex* would be incapable of repayment because of the plunge in the Bank's securities portfolio value;

- As a result of global financial crisis the quality of *Parex* foreign securities portfolio had worsened; *Parex* had no parent bank, which could assume issuing additional guarantee or any collateral to *Parex c*reditors.

## 2. NECESSITY OF TAKEOVER

2.1. Presumptive consequences if no bailout of *Parex* carried out

If the Cabinet had not decided on the takeover of *Parex*, the Bank actually would have been exposed to inevitable insolvency in the nearest future. Eventually, there would be enormous negative consequences in the national financial system afterwards as a result of potential insolvency, including:

- The Government should have to pay guaranteed compensations to *Parex* depositors in accordance with Deposit Guarantee Law. In three months, a total of about 660 million lats would have to be paid to depositors. However, at that time the Deposit Guarantee Fund contained only 82.9 million lats, thus the rest should be paid from the Latvian State budget, but the latter lacked the required funds as the Latvian State had not yet entered into an agreement with international lenders, European Commission and International Monetary Fund regarding the opening of credit line.
- Numerous central and local government institutions, which had their current accounts and salary accounts with *Parex,* would have to encounter problems with fulfilment of the Bank's obligations. Total central and local government deposits with *Parex* accounted for 143 million lats on 30 September 2008.
- Material loss would be caused to the business environment because of delays in mutual payments thus resulting in further national economy downturn and GDP decrease, and problems with liquidity on an overall scale of national economy and potential decrease in deposit volumes, including non-resident deposits.
- Interbank payment system would be essentially impeded.

2.2. Strategic importance of takeover

By taking control over *Parex*, the Latvian State rendered assistance to the overall financial sector, not only to *Parex*, because the deepening of problems with *Parex* could have resulted into a domino effect. An increased financial sector confidence crisis, which could result into a dramatic outflow of funds to foreign banks and deep crisis of financial resource availability having a negative impact on the whole Latvian national economy.

Moreover, in the opinion of BoL, *Parex* insolvency would have left material negative impact both on the Latvian financial sector and payment system, undermining the foreign depositors' trust to the State for the following reasons:

- At the end of September 2008 *Parex* was a second-largest bank in Latvia **in terms of assets** and the Bank's assets constituted 13.8% of total assets of the Latvian banking sector. *Parex* had a significant role in servicing the Latvian retail and corporate transactions.
- Regarding the overall **payment system** of the Latvian State in first half of 2008 *Parex* ranked the third in terms of the opened client accounts (646 thousand) and issued payment cards (448 thousand); *Parex* ranked the third also as regards the number of client credit transfer performed in Latvia (4.5 million transactions) and payments by card (6.5 million transactions); *Parex* was the fourth largest bank in terms of the number of credit transfer

transactions (16.5 billion lats); *Parex* was the second-largest bank in terms of volumes of payments made by cards (167.7 million lats).

- In the BoL's interbank automated payment system (SAMS) *Parex* ranked the fourth in terms of the number of performed transactions and the fifth in terms of transaction volumes.
- In the BoL's electronic clearing system (EKS) *Parex* was second in terms of the number of payments in lats and third in terms of volume.
- In the BoL's interbank euro payment system TARGET2-Latvija *Parex* was second in terms of the number of transactions and third in terms of transaction volumes. Within EKS *Parex* was second both in terms of the number and volumes of payments in euro.
- In the period from 16 October 2008 and 23 October 2008, *Parex* transactions in the Latvian money market constituted 2% of total turnover of local interbank money market; *Parex* share in the turnover of local currency market was 23% in September 2008.
- At the end of September 2008 *Parex* had attracted 13.6% of total Latvian resident deposits, including 14.5% of total private individual deposits and 11.8% of corporate deposits.
- *Parex* market share in the corporate lending constituted 7.4%, and retail lending, 8.8%. *Parex* was a leading bank in terms of non-resident deposits, accounting for 26.2% of total non-resident deposits placed in Latvia.

By taking over *Parex*, the Latvian State prevented insolvency of the leading credit institution stabilizing the Latvian financial system and attesting that the Government stood ready to render assistance to depositors. Collapse of such a bank as *Parex* could create even bigger losses to the whole financial system than the total amount of *Parex* rescue funds, as the Bank's customers, residents, non-residents, natural and legal persons, would have lost trust in all banks, seriously striking at the heart of the whole sector. It should be noted that the deposit outflow in September, October and November of 2008 was not limited to *Parex*, it was observed also in several banks in Latvia. Meanwhile, the volume of deposits grew in several other banks, which depositors regarded as safer banks. Total deposit volume in the banking sector fell in October 2008 month-on-month, but already in November deposits started growing, proving high enough depositor confidence in the banking sector overall.

## 3. TAKEOVER PROCESS

### 3.1. Taking over majority stake in *Parex* by the State

In early November 2008 it was clearly evident that *Parex* would instantaneously go bankrupt if no State assistance rendered. Whereas allotting the state support provided that *Parex* remained under shareholders control would cause concern about adequate use and recovery of state funding. As a result of debate and considering experience of other countries (for instance, takeovers of *Northern Rock* and *Bradford&Bingley* in the UK), it was decided that the best solution would be taking control over the majority stake in *Parex* by the State. Theoretically the Bank's shares could have been taken over without the shareholders' consent pursuant to the provisions of Article 105 of Constitution (*Satversme*), but in that case complicated legal procedures should be applied, which would considerably delay the procedure and as a result it would be impossible to bailout *Parex*. Consequently, it was decided to hold negotiations on the Bank's takeover with *Parex* majority shareholders Valērijs Kargins and Viktors Krasovickis, who both owned 84.83% of *Parex* share capital. Takeover process further development as follow:

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| 03.11.2008 | Negotiations between FCMC, MoF, BoL and *Parex* that resulted in an agreement with V. Kargins and V. Krasovickis regarding transfer of 51% stake in *Parex* to the State for 2 lats (paying LVL 1 to each shareholder). |
| 04.11.2008-<br>21.11.2008 | FCMC conducted an inspection in *Parex* to evaluate the Bank's lending (reverse repo deals) process. In the inspection an insufficient amount of provisions was identified in *Parex* (totalling 2 million lats). |
| 04.11.2008 | The Cabinet in general supported the agreement with *Parex* shareholders V. Kargins and V. Krasovickis on the participation of the State in strengthening *Parex* capital base and set guidelines for the content of the agreement. |
| 07.11.2008 | Board of FCMC adopted a decision on necessity to notify the prime minister and minister of finance of applying restrictions on the fulfilment of *Parex* obligations. |
| 08.11.2008 | The Cabinet decided on taking control over 51% stake in *Parex* through Mortgage Bank. Upon the fulfillment of the conditions precedent, for the acquired shares the Latvian State undertook to support *Parex* issuing sureties for the refinancing of the *Parex* syndicated loans, as well as ensure funding used as a basis for the creation of the subordinated capital (in the amount of up to 200 million lats within two years). Thereby *Parex* liquidity maintenance had been actually supported. |
| 10.11.2008 | Investment Agreement was signed between the *Mortgage Bank*, *Parex*, the Republic of Latvia, V. Kargins and V. Krasovickis on the selling of 51% of *Parex* shares to *Mortgage Bank* for the purchase price of LVL 2. According to the Agreement, *Parex* shareholders V. Kargins and V.Krasovickis undertook to receive the unconditional consent for the share takeover transaction from the lenders of syndicated loans representing two third of the total syndicated loans. It was decided to seek a strategic investor for *Parex* to stabilize the Bank's financial standing. V.Kargins and V.Krasovickis received rights to repurchase shares, provided that all expenses in relation to the financial assistance, loans and guarantees issued by the State would be repaid.<br>The purchase of shares was postponed under several conditions, namely, in the event if:<br>EC has granted its approval to State aid. As the takeover of *Parex* is deemed as the State aid in terms of EU (Community) *acquis communautaire*, the EC consent was prerequisite for the takeover.<br>The Competition Board of the Republic of Latvia and FCMC have issued consent to the transaction pursuant to national laws.<br>V. Kargins and V. Krasovickis receive unconditional, irrevocable written consent of two third of the total syndicated lenders for the takeover.<br>Other conditions of the Agreement (pledging of the rest capital shares and movable or immovable property owned by V. Kargins and V. Krasovickis, keeping all the current deposits in the amount of 14 million lats of V.Kargins and V.Krasovickis in *Parex* accounts etc.).<br>Several restrictions were imposed on *Parex* regarding decision-making and activities from the signing date of Investment Agreement until the closing date.<br>According to the Investment Agreement, in the event all the conditions precedent have not been fulfilled within 2 weeks, the Mortgage Bank and the Republic of |

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| | Latvia have the right to terminate the Agreement.<br>On the same date MoF instructed the State Treasury to place a term deposit totalling 199 999 924.63 lats with *Parex*. Funding from the issue of Latvian treasury bills was used for placing the deposit. *Parex* used the acquired securities as collateral in order to borrow the funding from BoL to maintain liquidity. |
| 12.11.2008 | MoF required the State Treasury to place a term deposit in the amount of 100 000 000 lats with *Parex* until 19.11.2008. A pledge agreement was signed with *Parex* regarding collateral of the funds; later the term was extended. |
| 12.11.2008-<br>27.11.2008 | Sworn auditors *PriceWaterhouseCoopers* conducted an analysis of initial financial situation in *Parex*. During the examination *Parex* financial instruments portfolio was evaluated to ascertain whether the standing of *Parex* could have been improved by taking the Bank under the State control. |
| 14.11.2008 | An agreement was signed between MoF and *Parex* regarding term deposits of State Treasury with *Parex*, signing a separate agreement on each deposit. *Parex* had to put financial pledge, mortgage or commercial pledge as collateral in favour to the State Treasury. On the basis of this basic agreement, the State Treasury placed several term deposits with *Parex* in accordance with the amounts and terms set by MoF. |
| 22.11.2008 | FCMC sent a letter to FoM on recalling the Bank's Board members. |
| 25.11.2008 | EC consent on the takeover of *Parex* was received. |

3.2. Further steps for increasing influence of the State

3.3. When the decision on the taking controlling interest in *Parex* by the Latvian State was publicly disclosed, the reaction of public and *Parex* depositors to it was rather different. Some backed the move of the Government, while other were concerned about the takeover of *Parex* taking it as a signal on an inevitable *Parex* bankruptcy and hastily withdrew their deposits from the Bank. To ensure stabilization of *Parex* and overall Latvian financial system as soon as possible, an efficient action was required for normalization of the situation in *Parex* and deciding on the Bank's further status. Further developments leading to increasing of influence of the State in *Parex* equity capital were as follow:

| *Date* | *Event* |
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| 25.11.2008 | V.Kargins and V.Krasovickis failed to receive consent of two third of syndicated lenders for the takeover of *Parex* failing to fulfil the conditions set forth in Investment Agreement. According to outcome of negotiations with the syndicated loan lenders, an agreement on the loan refinancing could have been reached if the Mortgage Bank owned all Parex shares in possession of V.Kargins and V.Krasovickis. The same was the outcome of talks with Sweden's central bank, International Monetary Fund and EC regarding possible assistance, namely, the State control over at least 85% of *Parex* shares, as well as change of entire Bank's management. Increased State control over *Parex* was required also to ensure risk mitigation in relation to State, i.e. to minimize possibilities to use the State aid in interests of private individuals.<br>Thereby debates started on amending the Investment Agreement stipulating a |

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| | takeover of all shares owned by V.Kargins and V.Krasovickis, excluding the necessity to receive consent of syndicated lenders. |
| 01.12.2008 | Cabinet and FCMC decided to limit execution of *Parex* liabilities, in view of the excessive outflow of deposits and other funds after releasing information on Parex problems and the Bank's takeover. A decrease in liquidity ratio still was running on. The Cabinet and FCMC made a joint decision on imposing restrictions on execution *Parex* obligations, according to which debit operations related to commercial activities for private clients (natural persons) were limited to LVL 35 000 per month; and for corporate clients limited to LVL 35 000 per month, equal to LVL 350 000 or unlimited amount per month depending on the number of employees. Restrictions were set until 30.06.2009.<br><br>Imposing restrictions on fulfilment liabilities was most acceptable decision to prevent the outflow of assets from *Parex*, and it could be praised from today's point of view. |
| 03.12.2008 | The Cabinet decided to acquire all the *Parex* shares owned by the ex-major shareholders V.Kargins and V.Krasovickis, without changing the purchase price – a total of 2 lats. Agreement on Amendments to the Investment Agreement was signed, and as a result all the shares owned by V.Kargins and V.Krasovickis, constituting 84.83%, were taken over by the Mortgage Bank. Rights of repurchase of shares for the former shareholders were deleted from the Investment Agreement. The rest 15.17% of *Parex* shares remained in possession of former minority shareholders.<br><br>The Cabinet also required the Mortgage Bank to alienate investments in *Parex* not later than in 12 months of closing date of Investment Agreement. Thereby until 15.01.2009 the Mortgage Bank shareholders meeting had to approve the mandated lead adviser for the alienation process and start seeking an investor without delay. The Mortgage Bank was also designated to carry out in-depth legal analysis of *Parex* financial standing. |
| 05.12.2008 | Nils Melngailis, Guntis Beļavskis, Vladimirs Ivanovs and Valters Ābelis were elected as *Parex* council and board members. Evaluating proficiency and experience of candidates, Nils Melngailis was appointed as the Chairman of *Parex* Board. Former *Parex* shareholders, V.Kargins and V.Krasovickis, were recalled from the Bank's board. Appointment of new members of board took place under conditions of the Investment Agreement, according to which *Parex* was required to fulfil the decision of *Parex* council regarding electing persons nominated by the Mortgage Bank to *Parex* board. |
| 15.12.2008 | The Cabinet decided to increase the holding of the Mortgage Bank in *Parex* by the acquisition of all *Parex* shares owned by Svenska Handelsbanken AB. One of the *Parex* minority shareholders, Svenska Handelsbanken AB, already on 05.12.2008 had made an offer to the Latvian State to repurchase the 200 000 *Parex* shares in its possession for 1 euro cent.<br><br>The purchase agreement was concluded on 22.01.2009. After conclusion of this transaction, the Mortgage Bank holding in *Parex* was increased up to 85.15%.<br><br>The Cabinet expressed interest in possibilities to also acquire the shares of other *Parex* minority shareholders. |

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| 16.12.2008 | Pursuant to instructions of the Cabinet to ensure *Parex* liquidity MoF required the State Treasury to place an investment with *Parex* totalling 43 386 275.94 euro for the acquisition of the issued short-term treasury bills totalling 44 391 700 euro. The acquired securities *Parex* put as collateral when borrowing required funding from BoL to maintain liquidity. |
| 16.12.2008-26.01.2009 | Sworn auditors *PriceWaterhouseCoopers* conducted *Parex* financial and tax, and information technologies financial and tax due diligence as of 30.11.2008. Besides, financial statements submitted by the former major shareholders of *Parex,* V.Kargins and V.Krasovickis, were examined to verify their authenticity pursuant to the Investment Agreement. |
| 19.12.2008 | A new council of *Parex* was elected. The Investment Agreement stipulated that a *Parex* shareholders meeting was to be called not later than next business day upon receipt of relevant request of the Mortgage Bank. The key item on the agenda was election of the new council that would represent interests of the major indirect shareholder, i.e. the Republic of Latvia. |
| 22.12.2008 | The Cabinet decided to place a deposit of the State Treasury totalling 287 074 548 euro with *Parex* for the acquisition of the short-term treasury bills totalling 300 000 000 euro. The acquired securities *Parex* put as collateral when borrowing required funding from BoL to maintain liquidity. |
| 20.01.2009 | The Mortgage Bank selected the investment bank Nomura International plc. as lead advisor for the *Parex* alienation process, which was later approved also by the Cabinet. An international adviser was required to professionally arrange the process of selecting *Parex* strategic investor and alienation of *Parex* shares controlled by the State. |
| 26.01.2009 | Report of sworn auditors *PriceWaterhouseCoopers* on the results of in-depth financial examination in *Parex* was drawn up.<br><br>In January 2009, the outflow of funding from *Parex* had considerably decreased, and as a result no additional deposits made by the State Treasury were required. Notwithstanding, *Parex* ended the year 2008 with loss mainly due to expenses on loan loss provisions. |
| 16.02.2009-17.02.2009 | The Cabinet backed issuance of guarantee extensions in respect of *Parex* syndicated loan (500 million euro with maturity 29.06.2009 and 275 million euro with maturity 18.02.2009) according to the agreement between *Parex* and lenders, taking into account the planned recapitalization of *Parex*.<br><br>The Cabinet also supported increasing of *Parex* equity capital, which was a prerequisite for carrying out the EBRD transaction. |
| 24.02.2009 | The Cabinet decided to transfer *Parex* shares owned by Mortgage Bank to a professional manager of capital shares, namely, PA which has relevant experience and adequate resources for alienation of capital shares owned by the State, including experience of alienation of capital shares in credit institutions, for instance, JSC *Latvijas Krājbanka* and JSC *Latvijas Unibanka*. As a result, PA acquired 85.15% of *Parex* shares by signing a purchase agreement with Mortgage Bank on the acquisition of shares for 2 lats + 0.01 euro.<br><br>Such a decision was made to preclude possible inclusion of *Parex* in Mortgage Bank |

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| | consolidated group in accordance with international accounting standards. Consolidation would mean mutual risks and their taking over among associated companies. However, it had always been of strategic importance for Mortgage Bank to participate in specialized State aid programs aimed at business promotion and therefore there was a necessity for reducing the scope of Mortgage Bank and risks not related with performing above functions.<br><br>Arrival of EBRD representatives in Riga to launch negotiation on possible involvement of EBRD in *Parex* equity capital. |
| 10.03.2009 | The Cabinet backed repayment schedule of *Parex* syndicated loans on conditions as follow:<br><br>March 2009 – 30% (232.5 million euro),<br><br>February 2010 – 40% (310 million euro),<br><br>May 2011 – 30% (232.5 million euro).<br><br>The above terms were supported also by BoL and FCMC. The State Treasury was designated to ensure placing the deposit with *Parex* for carrying out the first payment (March 2009). The minister of finance had to issue the State guarantee to the syndicated lenders for the remaining payments (February 2010 and May 2011). |
| 18.03.2009 | To ensure entering into an agreement with the syndicated lenders in accordance with the payment schedule approved by the Cabinet on 10.03.2009, the minister of finance signed two contracts of guarantee and compensation: the credit agreement of the 21 February 2008 for 275 000 000 EUR and the credit agreement of 29 June 2007 for 500 000 000 EUR. |

Since the takeover of *Parex,* the State Treasury deposited a total of 837.3 million lats in term deposits with *Parex* in the period between 10 November 2008 and 17 March 2009. At the end of term *Parex* must repay the deposits placed in the Bank to the State. Currently, all term deposits placed by the State with *Parex* have been secured by relevant pledge agreements; deposits have been placed as term deposits with fixed interest rates. Total contractual loan collateral amounts to 1 billion 17 million lats, which exceeds the total amount of placements made by the State Treasury. Therefore to sum up, direct expenses on the acquisition of *Parex* shares constitute only 2 lats and 1 euro cent, paid to the former *Parex* shareholders for the takeover of shares by the State. The rest of State aid to *Parex* are deposit transactions which would not cause loss to the State assuming that *Parex* continue commercial activities.

The Law on Bank Takeover was also drawn up and passed by the Parliament (*Saeima*) on 18 December 2008. The Law specifies the cases where the bank takeover is permissible and the procedure according to which the State may take over a bank. The Law sets a legal framework for tackling problems in the banking sector, to provide a mechanism for taking over the bank and setting the amount of compensation to shareholders. The Cabinet Regulations No 112 of 10 February 2009 on the procedure for setting, offering and payment of the amount of fair compensation to the bank shareholders or a bank issued on the basis of the Law on the Bank Takeover took effect on 13 February 2009.

## 4. FURTHER DEVELOPMENTS

Since the Latvian Privatisation Agency has become the majority shareholder of *Parex* looking for strategic investors is one of the key tasks of PA, as a State representative. The State is not interested in retaining the shares of *Parex* in its possession for unlimited period of time, but to attract investors who would acquire the State shares and continue stabilizing of *Parex* and further development.

This objective was partially attained on 16 April 2009, when the agreement was signed with EBRD on the acquisition of *Parex* shares. In accordance with the agreement, EBRD will invest a total of 73 million lats in *Parex* capital. By the acquisition of 25% + 1 of ordinary shares of *Parex,* EBRD will invest 59.5 million lats and 15.5 million lats (22 million euro) in the *Parex* subordinated capital, which later would be transformed into shares or recovered as a loan. EBRD has a great experience in restructuring banks and involvement of EBRD into *Parex* equity capital could be taken as a positive signal regarding *Parex* potential viability and development.

Presently, several restrictions on *Parex* activities regarding financial services, including granting new loans, imposed by the Cabinet and FCMC are still effective. Thus a topic short-term goal is to fully restore *Parex* financial services, promoting the rightful returning of the Bank in the financial services market.

| *Date* | *Measures taken* |
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| 24.03.2009 | Following Section 59.5, paragraph 1 of the Credit Institution Law took effect and the approving decision of the EC regarding compatibility of the planned aid with the Treaty establishing the European Community the Cabinet resolved that the State should indirectly increase qualifying holding via LPA by the acquisition of newly issued 165 000 000 name shares to which voting rights are attached with a nominal value of 1 lats and LPA should invest 62 000 000 lats in Parex subordinated capital in order to maintain Parex capital adequacy. |
| 11.05.2009 | EC authorized the Latvian government to acquire the newly issued shares, thus raising Parex share capital, as well as to make investment in Parex subordinated capital. The EC consent was required for receiving additional State support and improving the Bank's capital adequacy ratio. The EC permitted the Latvian government to make injections into Parex share capital and subordinated capital in the amount needed for maintaining the Bank's capital adequacy ratio at 11%. |
| 19.06.2009 | However, up to date, the Bank did not have a sufficient amount of liquid resources available for performing financial transactions fully on its own without the State support, consequently the Board of the FCMC decided to extend the period of restrictions on the settlement of liabilities as set by the Decision No. 1 On the Setting of Restrictions on the Fulfilment of Obligations by the JSC "Parex banka" of 01.12.2008 of Cabinet of Ministers and the Financial and Capital Market Commission until 30.11.2009. |
| 23.07.2009 | EBRD entered into a 22 million euro subordinated loan agreement with Parex, as well as agreed on modifications to the share purchase agreement and shareholders agreements. |
| 13.10.2009 | To ensure adequate capital of Parex the Cabinet of Ministers decided that the State should indirectly increase the qualifying holding in Parex through PA by the acquisition of newly issued 24 250 000 name shares without voting rights with a nominal value of 1 (one) lats. |
| 29.10.2009 | Parex's share capital was increased by 24 300 000 lats. |
| 13.11.2009 | As Parex's liquid assets still were insufficient to perform the full scope of financial operations without any additional State support, the Board of the FCMC decided to |

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| | extend the period of restrictions on the settlement of liabilities as set by the Decision of Cabinet of Ministers and the Financial and Capital Market Commission of 01.12.2008 on the setting of restrictions on the fulfilment of obligations by the JSC Parex until 30.06.2010. |
| 17.11.2009 | The Government in principle agreed on restructuring or splitting-off Parex and assigned PA to submit the new restructuring plan until 30.12.2009. To ensure efficient consultation procedure, the Cabinet of Ministers decided to set up an inter-institutional working group for monitoring fulfilling of the agreement, comprised of representatives from the Ministry of Finance, FCMC, Bank of Latvia, PA and State Treasury. |
| 25.01.2010 | An agreement entered into with the international consulting company Nomura International plc involved preparing and implementing the restructuring plan and the sale of Parex. |
| 09.02.2010 | The Government backed additional funds to Parex in terms of time deposit in the amount of 102 million lats in order to repay the loan to the syndicate lenders. |
| 15.02.2010 | Parex made a regular syndicated loan payment in the amount of 310 million euro (218 million lats). |
| 15.02.2010 | Parex issued Eurobonds in the amount of 17.68 million euro (12.4 million lats). The first issue of Parex's debt securities took place, issuing bonds in the amount of 17 680 000 euro and two-year deposit contracts were concluded under relevant conditions in the amount of 130 million euro (91.4 million lats). |
| 23.02.2010 | The Government approved a decision to increase the share capital of Parex by 31.5 million lats. |
| 26.02.2010 | The share capital of Parex has been increased by 31.5 million lats, amounting to 261 527 295 lats. |
| 23.03.2010 | The Latvian Government adopted a decision on Parex restructuring model separating part of assets into a new company (new bank). In accordance with the model selected, Parex's restructuring plan was also approved. Ministry of Finance was assigned to submit the restructuring plan to the European Commission (EC) for approval. |
| 31.03.2010 | Parex's restructuring plan was submitted to the EC. |
| 01.06.2010 | Pursuant to Parex restructuring model regarding a new bank backed by the Cabinet of Ministers, the Government assigned PA to found a credit institution with a 100% state-owned capital.<br><br>The Government assigned PA, after receipt of EC authorization for the Bank's restructuring plan, to increase share capital of the new bank to the amount of State support as determined in the restructuring plan. |
| 11.06.2010 | To prevent an unpredictable outflow of funding from Parex, thus retaining moderate changes in deposit stock that would ensure Parex's stability and solvency and successful implementation of the restructuring plan, the FCMC Board decided to extend the period of restrictions on the settlement of liabilities as set by the Decision of Cabinet of Ministers and the Financial and Capital Market Commission of 01.12.2008 on the setting of restrictions on the fulfilment of obligations by Parex until 31.12.2010. |

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| 18.06.2010 | To implement the restructuring plan under the Cabinet of Ministers' 1 June 2010 resolution, PA had to establish a credit institution with initial share capital of 4 million lats. On 18.06.2010, a loan agreement was entered into by the Ministry of Finance and PA on financing the share capital of the new bank.<br><br>Part of previous deposits in Parex was used for paying loan, thus reducing the total amount of deposit made in Parex by the State Treasury. |
| 29.06.2010 | On 29.06.2010 the FCMC Board decided to issue a credit institution operating licence to the joint-stock Citadele banka, the newly-established credit institution as the result of restructuring of Parex, founded by the Latvian Privatization Agency.<br><br>Financial and Capital Market Commission also supported the appointment of Juris Jakobsons as the Chairman of the Board at Citadele banka, as well as Guntis Belavskis and Valters Abele as board members; the new bank's council members Andzs Ubelis, Juris Vaskans and Klavs Vasks, and Amanda Bikse – the head of the new bank's internal auditing department. |
| 30.07.2010 | FCMC Board decided to authorize Parex to transfer its credit institution undertaking to the joint stock Citadele banka. |
| 30.07.2010 | Parex filed a suit in court against its former co-owners, Valerijs Kargins and Viktors Krasovickis, seeking to collect compensation for losses caused to the bank during their office. Having analysed loan and deposit agreements that were concluded in the period from 1 January 1995 to 5 December 2008 between Parex and both former board members (who were also the bank's majority shareholders), as well as with other persons related, a series of transactions were identified which were performed in contradiction to the bank's interests, and applying particularly disadvantageous terms which were much different than those which would usually apply to agreements concluded by unrelated parties. |
| 01.08.2010 | Citadele banka, established after reorganization of Parex, started operating. |
| 15.09.2010 | European Commission (EC) authorized the restructuring plan of Parex, accepting its compliance with the EU principles of State aid control. In the EC opinion, the Government's plan would secure Citadele banka longevity, at the same time providing an opportunity to put the remaining Parex's assets to good use. |